IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 160

Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc.,

Petitioners,

vs.

Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, The Western Realty Company, The Standard Realty and Development Company and Delta Finance Co., Ltd.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONERS

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In reply to respondents' brief ("RB" hereinafter) we propose to show that:

1. Respondents' arguments on the merits are without substance (Points I-IV, *infra*);

2. The alleged defense of bankruptcy bar is contrary to respondent's assumption agreement, to an express statute and to an unbroken line of authorities (Point V, *infra*); and

3. The defenses of statute of limitations, laches and estoppel are unfounded (Point VI, *infra*).

Respondents' brief is replete with factual inaccuracies. We do not propose to pursue them beyond listing a few in the footnote * and answering a few others in the context of this brief. The correctness of the facts set forth in our main brief ("MB" hereinafter) has nowhere been specifically challenged by respondent.

On the merits we believe that the case cannot be disposed of by broad generalizations such as that plaintiff has "no standing in court" because its claim does not fit the conven-

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* Respondent says that "all duality ceased" on December 31, 1944, when respondent came out of reorganization (RB 17, 37, 79, 101, 106). The fact is that, after that date as before, plaintiff's officers (Curry, Wienken, Valouch) remained in the pay of respondent; so did a majority of plaintiff's directors; and so did plaintiff's tax counsel (our main br., pp. 13-18).

Respondent says that plaintiff's president Curry had "handled" or "managed" "tax matters for the Western Pacific group for many years" (RB 16, 22). But respondent's citation to the record (R. 841-5) shows no more than that Curry, as plaintiff's signing officer, signed the tax returns and other correspondence. The fact is that these tax matters were handled by respondent's employee, Miss Valouch (R. 647, 659, 846; Pl. Ex. 29, R. 527, 1737), who was "the only person in the corporation office over here in New York who has any knowledge of taxes" (Pl. Ex. 38-A, R. 539).

Respondent says that Curry was consulted from time to time in connection with the preparation of the 1943 tax returns (RB 13). The record cited by respondent (R. 1415) does not so state.

Respondent says that plaintiff "did not suffer from lack of information" concerning its rights because in November, 1944 Mr. Nicodemus discussed the possibility of a tax saving claim with certain other lawyers (RB 17). The fact is that Nicodemus was neither an officer nor a director of plaintiff (he did not become a director until the commencement of this action); that he never communicated his ideas to plaintiff (R. 1064); and that, while he was counsel for plaintiff, he was also counsel for respondent and its trustees and drew his pay exclusively from them (MB 17).

Respondent asserts that its corporate existence commenced on January 1, 1945 and that it is therefore wholly different from the pre-reorganization operating company and its trustees (RB 24-25). The fact is that, before as after the reorganization, the operating company was the same legal entity, as is evidenced by the bankruptcy court's "revesting order" of November 27, 1944 (Pl. Ex. 14, R. 499, 1711, 37, 42, 62-63), and that respondent, upon emerging from reorganization, assumed the obligations of its reorganization trustees (Pl. Ex. 14, R. 45-46, 78).

tional categories of "tort", "contract" or "statutory right" (RB 72). The case, as we see it, turns on two questions:

1. Was the relation between the parties such as to subject respondent to the fiduciary duty of dealing fairly with plaintiff?

2. If so, did fairness permit respondent to take all, and give plaintiff none of the tax savings which respondent derived from the use of plaintiff's tax credit?

The affirmative answer to the first question—respondent's duty to deal fairly with plaintiff in the tax transaction—does not seem to be seriously disputed. Respondent cannot and does not deny the existence of duality; the record incontrovertibly establishes, and both Courts below found it. Nor does respondent deny the well established fiduciary consequences normally flowing from duality. Instead it seeks, by eroding exceptions, to whittle away this doctrine in its application to this case.

Thus respondent claims (RB 5, 21, 80, 106) that plaintiff cannot complain of the duality which it allegedly created; but the argument is factually and legally without merit (MB 41-42, 82-83), and the authorities cited by respondent (RB 80) do not sustain it.*

Respondent also says that the dual officers acted honestly and openly (RB 21); but good motives and lack of secrecy are no defense; the objective tests of fairness must still be met (MB 42-45).

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* Neither *Rosaly v. Gonzalez*, 106 F. 2d 169, 172 (C. C. A. 1, 1939), nor *Myers v. Louisiana & A. R. Co.*, 7 F. Supp. 97, 99 (D. C., W. D. La., 1934), deals with interlocking managements, let alone with duality created by one of the parties. The cases pronounce the hornbook rule that "When appealing to a court of equity * * * the plaintiff should not himself be responsible for the condition of which he complains". We do not "complain" of the duality; we merely invoke the rule that, whatever the origin of dual managements, dual corporations must act fairly when dealing with each other.

Respondent further makes the curious argument (RB 80-81) that Curry and the other officers of plaintiff were not "dual" because their rival employers were respondent's reorganization trustees, "officers of the reorganization court", who "had no personal interest in the reorganization". But the laws of psychology are not suspended by the titles conferred by a bankruptcy court. Whether or not the dual actor is cast in some official role, there is the same attempt simultaneously to serve two masters; there is the same divided allegiance; and consequently there is a lack of independence and arm's length bargaining. The authorities therefore, taking a realistic view, apply the duality rule to receivers, trustees and other court-appointed officers no less than to regular corporate officers and directors. *Koral* v. *Savory, Inc.*, 276 N. Y. 215, 220, 11 N. E. 2d 883 (1937); *Brinckerhoff* v. *Bostwick*, 88 N. Y. 52, 60 (1882); *In re James Estate*, 86 N. Y. S. 2d 78, 84 (Surr. Ct., 1948); *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 88 (D. C., S. D. Cal., 1941).

Finally, in lieu of the duality rule with its requirement of fair dealing, respondent argues that plaintiff, as respondent's parent, owed fiduciary duties to respondent (RB 76-79). But this attempted reversal of roles must fail because respondent cannot and does not show, in addition to mere stock ownership, any control by plaintiff of respondent or its trustees—a well established prerequisite for the imposition of fiduciary obligations on a stockholder (see MB 65-67).

We turn therefore to respondent's arguments as they bear on the second question herein: Whether respondent breached its duty to deal fairly with plaintiff by taking all, and allowing plaintiff none of the benefits produced by the use of plaintiff's tax credit.

POINT I

Respondent's retention of the tax benefits was unfair because plaintiff, not respondent, was, under the tax laws, the intended beneficiary of those benefits.

The tax laws primarily involved herein are §§ 23(g)(4) and 141 of the Internal Revenue Code.

With respect to the purpose of § 23(g)(4) respondent does not dispute or answer the conclusion that its purpose, in recognizing plaintiff's stock loss as a tax credit against ordinary income, was to mitigate the economic impact of that loss and hence to benefit plaintiff which alone suffered the loss.

Respondent does, however, attempt to dispute our contention that the purpose of § 141 in permitting consolidated returns was to benefit the parent as the ultimate owner of the group. However, by its own concession respondent has sustained the validity of our contention. Thus respondent, in describing the purpose of consolidated returns, states that

> "they permit a business organized by subsidiaries to pay no more tax than a business organized by departments where the losses of one department freely offset the profits of another". (RB 28, 51-52)

Or, as stated in the Memorandum of the Senate Finance Committee on the 1918 Revenue Act, quoted by respondent (RB 51, fn. 20):

> "Where a corporation does business through subsidiary corporations, such subsidiaries represent in effect merely different departments of the business. It is just as illogical to tax these subsidiaries separately as it would be to levy a separate tax upon the profits earned by different departments of a single corporation."

As plainly as words can state it, the language of the above and respondent's concession must mean that the subsidiaries' losses and profits are to be consolidated with the parent's for the same reason a department's losses and profits are. The profits and losses of subsidiaries, like those of departments, are viewed as being in fact the profits and losses of the single economic entity under the common ownership of the parent and its stockholders. Necessarily any benefits resulting from this consolidation of earnings and losses must likewise be intended for the common owner, the parent, and not for its subsidiaries or its departments. Respondent's own concession demonstrates the complete illogic of any contention that the intended beneficiary of consolidated returns was itself, the subsidiary, rather than plaintiff, the parent.

As significant as respondent's concession are its omissions. Nowhere in its brief is there a single precedent stating that consolidated returns were intended not for the benefit of the parent but for the benefit of its subsidiary or departments. Nowhere in its brief is any attempt to justify or support the reasoning by which the Court below reached this unprecedented conclusion (see our main brief, pp. 54-58). Instead, respondent merely shrugs off the whole idea that the parent, as the common owner, was the intended beneficiary of consolidated returns.

This analysis, says respondent, is "a singularly unsophisticated view of holding company systems" (RB 52, 60-62). Since consolidated returns can be filed with 5% of the equity and voting stock of the subsidiary in the hands of the public, along with non-voting preferred stock, notes and bonds of the subsidiary, it follows, says respondent, that such systems, filing consolidated returns, are not "single ownerships". (RB 52), and that any intended "economic unity" between subsidiary and parent is, in

matters related to consolidated returns, "a false factor demonstrably of no significance" (RB 60).*

But our position, however unsophisticated, happens to be that of this Court; *Atlantic City E. Co.* v. *Commissioner*, 288 U. S. 152, 154 (1933):

> "The requirement of consolidated returns was 'based upon the principle of levying the tax according to the true net income and invested capital of *a single business enterprise*, even though the business is operated through more than one corporation.' Treasury Regulations No. 45, Art. 631." (Italics added)

It happens also to be the view of Congress. Thus the *Report of the Senate Finance Committee*, 70th Cong., 1st Sess., S. R. 960, p. 14 (1928):

> "* * * it is only when the corporations are but really one corporation that the permission to file consolidated returns is given, * * *."

And similarly the *Report of the House Ways and Means Committee*, 73d Cong., 2d Sess., H. Rep. 704, p. 17 (1934):

> "For all practical purposes the various subsidiaries, though technically distinct entities, are actually branches or departments of one enterprise."

The "economic unity" of the affiliated group, stemming from the parent's common ownership, is thus the cornerstone of consolidated returns. It furnishes the justification for the privilege of the parent, as the common owner of the group, to offset group losses against group profits. It entitles the parent, in accordance with the purpose of the

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* Respondent's citation (RB 62) of *Commissioner* v. *Phipps*, 336 U. S. 410, 421, fn. 15 (1949), is inapposite. The case did not involve consolidated returns at all; nor did it discuss the nature and extent of a parent's interest in the assets and income of its subsidiary. The portion of the opinion quoted by respondent merely holds that, upon the tax-free liquidation of a subsidiary, the existence of a surplus or deficit in the accounts of the subsidiary does not determine the amount of the profit or loss which the parent realizes as the effect of the tax-free transaction.

statute, to enjoy the benefits flowing from its exercise of this privilege since the tax savings of all group members are actually the tax savings of the parent and redound to the parent's benefit by enhancing its equity in its subsidiaries.*

Nothing respondent has shown militates against these conclusions. There is no justification in the tax laws for respondent, the subsidiary, and not plaintiff, the parent, to retain the tax savings flowing from plaintiff's loss in consolidated returns.

We turn now to respondent's other arguments to ascertain what can possibly render fair respondent's retention of tax benefits which the tax laws intended for plaintiff.

POINT II

The precedents and the policy considerations which, according to respondent, militate against tax saving payments, apply only to unified groups of corporations and are therefore inapplicable where, as here, the economic unity has been severed.

Respondent argues (RB 41 et seq.) that, since the inception of the consolidated return statute, huge numbers of such returns have been filed. In all these cases, according to respondent, the inter-company allocation of the consolidated tax has "always" (RB 42) been determined according to one formula: The tax was distributed among

* The Court below concedes that this is true in the "usual case" (R. 2230). But respondent says (RB 62) that this automatic upstream flow of the subsidiary's tax savings to the parent will not take place if the subsidiary's bonds are in default, its debenture interest not paid, preferred stock in arrears or general creditors unsatisfied. But even in these unusual cases any tax savings of the subsidiary will reduce these senior charges and thus improve the value of the parent's equity stock in the subsidiary, unless and until an approved reorganization plan of the subsidiary cuts off the parent's interest in the assets and earnings of the subsidiary—which is the case at bar.

the group members in proportion to their respective taxable incomes; but no "tax saving payments" were made to the loss companies who contributed a tax credit. This formula, says respondent, is intrinsically fair; it has been followed by the Western Pacific group; it has been approved by many administrative agencies; its abandonment would create great uncertainties in the law, would engraft on an already elaborate tax system an equally elaborate system of tax saving payments, and would upset thousands of consolidated return transactions now considered closed.

All of these arguments, we submit, have one fundamental error in common: Respondent's refusal to recognize the fact that plaintiff's economic severance herein differentiates this case from the usual cases of consolidated returns.

We have never contended, as respondent suggests (RB 24), that every use of a loss in a consolidated return gives a right to compensation. On the contrary, we have said (MB 60) and say it again: In the normal case of an economically unified affiliated group, there is ordinarily no need and no justification for a tax saving payment. For if in such a unified group the parent sustains a loss and its subsidiary has profits, the subsidiary's tax saving through consolidated returns automatically benefits the parent; the purpose of the tax laws is thereby achieved; and with that purpose achieved, there are, as a rule, no equitable reasons for a tax saving payment. Conversely, if the parent has a profit and the subsidiary a loss, a tax saving payment by the parent to the subsidiary would be contrary to the purpose of the consolidated return statute; for that statute is designed for the parent's benefit, not the subsidiary's. Hence, in such situations it is ordinarily but fair to leave the tax savings in whichever pocket they fall.

But it is otherwise in the extraordinary and anomalous case where, as here, consolidated returns are filed by corporations whose economic unity has been wholly severed.* If in that case the subsidiary obtains for itself tax savings by using the parent's tax loss, the purpose of the tax laws is perverted: The parent, which suffered the loss and for whose benefit the consolidated returns are designed, receives no tax benefit whatever; while the profitable subsidiary obtains a tax windfall without rhyme, reason or justification. In this unusual case, the purpose of the tax laws is more nearly achieved if the parent obtains from the subsidiary all or at least a substantial part of its tax saving, in order to mitigate the parent's loss. And it is for this reason, we say, that fairness required the respondent here to make such a tax saving payment to plaintiff.

Respondent's brief thus poses a false issue. It devotes itself to a demonstration of the obvious, namely, that in the normal situation of an economically unified consolidated return group there is ordinarily no equitable justification for a tax saving payment. With that proposition we agree. But the question here is whether such payments are fair in the unusual and rare case where the economic unity is severed. To answer yes involves none of the dire consequences which respondent conjures up *in terrorem.* Our position would not, as respondent says, "upset thousands

* Respondent quibbles about whether this Court's decision of March 15, 1943 or the District Court's order of confirmation in November 1943 brought about this severance (RB 59-60); in any event, the economic unity was certainly severed by the time the consolidated returns were filed in 1944 and 1945. Equally inappropriate is respondent's attempt to establish that the economic unity had ended long before this Court's decision. Prior to this Court's decision affirming the plan, the Circuit Court of Appeals had reversed the plan because of the Commission's and the District Court's failure to justify the elimination of plaintiff's stock interest in respondent (Pl. Ex. 64, R. 626, 1781); until this Court reversed on March 15, 1943, the severance of the economic unity had not become an established fact. And all of this is affirmatively stated and recognized in Polk's letter to the Internal Revenue Department dated May 31, 1946 (Pl. Ex. 64, R. 626, 1779).

of consolidated return transactions now considered closed" (RB 38, 63); for virtually all of those transactions involved economically unified groups in which the purposes of the tax law were effectuated without tax saving payments. Our position would not "engraft upon an already elaborate tax system an equally elaborate system of tax saving payments" (RB 30, 55); for such payments could be called for only in the exceptional and rare case of economic severance. Our position would not "give to any party to the returns a right to demand a price for his consent" (RB 70, 29, 56); for the right to seek a tax saving payment exists only in the extraordinary case where, in the absence of such a payment, the purpose of the consolidated return law would be frustrated and the intended beneficiary denied its rightful tax benefits.

And, finally, our position is not contrary to the precedents cited by respondent; for those precedents, as we now proceed to show, relate only to the normal situation of an economically unified consolidated return group; and, moreover, they do not establish a rigid and unyielding allocation formula such as that proposed by respondent.

1. The alleged past practice of the Western Pacific group.

Respondent's brief claims not less than 15 times * that, during the 25 years up to 1943, the Western Pacific group had followed the practice of filing consolidated returns with no tax saving payments whatever. But the repetitiousness of the statement does not render it true. The fact is, as we have demonstrated (MB 70), that Utah Fuel Company, one of the affiliates joining with plaintiff and respondent in consolidated returns, did make substantial tax saving payments to plaintiff. As stated by respondent's own experts, Messrs Price, Waterhouse & Co.:

> "According to a letter dated June 26, 1928, from The Western Pacific Railroad Corporation to Utah

* RB 2, 3, 22, 25, 31, 42, 57-8, 59, 63, 65, 76, 79, 81, 83, 108-9.

Fuel Company, the net benefit which accrued to that company for the years 1922 to 1926, inclusive, resulting from the Treasury Department's agreeing that it was affiliated with The Western Pacific Railroad Corporation, was to accrue to The Western Pacific Railroad Corporation. * * * With respect to the tax for the year 1923, Utah Fuel Company paid over to The Western Pacific Railroad Corporation the amount of $60,475.84 representing the excess of the tax previously paid by the Utah Fuel Group, $131,744.72, over the amount computed as allocable to that group, $71,268.88."

(Def. Ex. 40, at p. 6)

Respondent says (RB 57, fn. 27) that this was not a payment for tax savings; but respondent prudently refrains from telling what it thinks the payment was for. Respondent also says (*ibid.*) that plaintiff, in turn, made certain other payments to Utah Fuel; but that does not change the fact that the $60,475.84 was a tax saving payment by an affiliate to plaintiff. The alleged practice of the Western Pacific group thus did not exist (see MB 70).

But even if it did, what is its relevance? Despite our challenge (MB 71), respondent does not even attempt to show why a practice followed prior to the economic severance should furnish a precedent for the period when the economic unity had ended.

2. The alleged general business practice.

Respondent offered proof at the trial that its allocation formula, which excludes tax saving payments, reflects the customary practice of affiliated groups filing consolidated returns (RB 42). The offer of proof was properly rejected as irrelevant (R. 1383), since respondent's proposed evidence did not relate to situations of economic severance.*

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* Respondent, though making no argument that the Court below committed any error in rejecting this evidence, nonetheless strews its substance all over its brief as if, despite the absence of cross-examination and rebuttal evidence, it had established the facts.

Any alleged practice of economically unified consolidated return groups is without significance to the issues at bar which turn upon the economic severance of plaintiff and respondent.

It may, however, be added that the alleged practice is by no means as general as respondent contends. Respondent's own authorities disclose that, before the enactment of the Public Utility Holding Company Act of 1935, a number of utility systems (such as Cities Service Company, North American Co., New England Power Association and others) made tax saving payments on a substantial scale (see RB, App. 5-8). The S. E. C. has since permitted tax saving payments in the very same field of public utilities. That this practice still persists in other businesses is evidenced by the recent case of *Beneficial Corp.* v. *Commissioner*, 18 T. C. ...., No. 47 (May 23, 1952) and by the Missouri-Pacific order (RB, App. 30-36). Moreover, had such proof been held relevant in the trial court, additional examples of tax saving payments by other substantial business groups could have been adduced.

3. The Securities and Exchange Commission.

Respondent contends that the S. E. C.'s Rule U-45(b)(6) (see MB, App. 103) "does not permit 'tax saving' payments for losses in consolidated returns" (RB 43). Nothing could be further from the truth. The Rule merely provides that tax saving payments shall not be made without the approval of the Commission. Such approval has been granted by the Commission in a number of instances of which we cite only the following:

Matter of Consolidated Electric and Gas Co., 15 S. E. C. 161 (1943);

Matter of Cities Service Company, 17 S. E. C. 839 (1944);

Matter of Consolidated Electric and Gas Co., The Islands Gas and Electric Co., 13 S. E. C. 649 (1943);

Matter of Ogden Corp., 19 S. E. C. 717 (1945);
Matter of United Public Utilities Corp., Holding Company Act Release No. 6375, 11 Fed. Reg. 986-7 (1946).

Respondent attempts (RB 44-46) to distinguish these cases on the theory that the tax saving payments there were authorized in order to compensate the loss companies for the disadvantages to them arising from their joining in consolidated returns. But in the first two of the cases just cited there was no such disadvantage whatever; and in the third, the tax saving payment far exceeded the amount of the recipient's disadvantage. Whatever the grounds of the decisions, they make it plain that respondent's allocation formula, far from embodying an absolute and rigid rule, will yield to exceptions wherever equitable considerations justify a tax saving payment.

Respondent also quotes (RB 42, App. 15) a footnote appearing in an accounting release of the S. E. C.* which states:

> "If one of the included companies operated at a loss, the consolidated tax is of course reduced, but no part of the 'saving' is *ordinarily* paid over to the loss company by the other members of the group." (Italics added)

The Commission's use of the word "ordinarily" makes it plain that its formula is subject to exceptions on grounds of equity and fairness.

The Commission's Rule U-45(b)(6) was of course designed for the ordinary case of economically unified consolidated return groups. It was not designed for the anomalous situation of economic severance. In the presence of economic severance, the purpose of the tax laws makes it fair for a profitable subsidiary to allow to its parent all or a substantial part of the tax saving derived from

* Release No. 53, Accounting Series, November 16, 1945, 61 Pub. Util. Rep. (NS) 193, 222, fn. 36.

the use of the parent's loss. The Commission has clearly stated that the purpose of its Rule U-45(b)(6) is "to effect a fair distribution of taxes based on consolidated returns"; *Matter of Cities Service Co., supra*, 17 S. E. C. 839, 843.

4. The Federal Trade Commission.

Respondent invokes (RB 47-8) a report of the Federal Trade Commission * as supporting its allocation formula and condemning tax saving payments. The F. T. C.'s investigation, which led to the enactment of the Public Utility Holding Company Act of 1935, dealt solely with electric and gas utility systems. In its report, the F. T. C. found that these systems made wide use of tax saving payments from the operating companies to their parents. The F. T. C. disapproved this practice because it increased the expenses of the operating companies and hence the rates charged to the public. But all the illustrative examples cited by the Commission were instances of economically unified holding company systems (RB, App. 5-8), in which the tax benefits of consolidated returns automatically redounded to the parent through dividends or increased equity values, without any need for tax saving payments. The F. T. C.'s disapproval of the practice does not, therefore, reach the present case in which the economic unity was severed so that, in the absence of a tax saving payment, the parent got no benefit and the subsidiary an undeserved tax windfall.

Pursuant to its conclusions, the F. T. C. recommended to Congress the adoption of an "amendment to the Federal income-tax law to prevent collection of anticipated income taxes from operating subsidiaries by holding companies

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* Federal Trade Commission, Summary Report to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Sen. Doc. No. 92, Parts 72-A and 73-A, 70th Cong., 1st Sess. Excerpts from the report are set forth in the appendix of respondent's brief, at pp. 5-9.

and nonpayment to the Government" (Report, quoted RB, App. 9). This recommendation, if adopted by Congress, would have established a rigid rule forbidding tax saving payments. Congress, however, rejected the recommendation, presumably because it considered such a rigid prohibition unwise. Although the practice of tax saving payments was forcefully called to the attention of Congress, and although Congress must have realized its prevalence outside the utility field, it did not see fit to alter the tax laws which permitted the practice. Only in the field of public utilities, Congress delegated the subject for regulation to the Securities and Exchange Commission (Public Utility Holding Company Act, § 12; 15 U. S. C., § 79-1). The S. E. C., in turn, as we have seen, far from promulgating an absolute bar of tax saving payments, permitted them subject to the approval of the Commission where it finds them fair and reasonable.

We submit, therefore, that the F. T. C.'s report is no authority for denying a tax saving payment where, as here, the peculiar circumstances of the case render the payment fair.

5. The Senate Committee on Interstate Commerce.

Closely related to the F. T. C. report just mentioned is a colloquy, cited by respondent (RB 52-54), which occurred in the course of hearings before the Senate Committee on Interstate Commerce, when that Committee considered the bill which ultimately became the Public Utility Holding Company Act of 1935. The Chairman of the Committee, Senator Wheeler, referred to the tax saving payments listed in the F. T. C.'s report, and apparently disapproved of them. Since, however, those payments were made by members of economically unified groups, Senator Wheeler's attitude has no bearing on the present case.

Moreover, Senator Wheeler recognized that the practice of tax saving payments was in accordance with law:

> "Senator Hastings: How did the income-tax people ever let them get away with a thing like that?
>
> "The Chairman: Congress, as a matter of fact, permitted it to be done under the consolidated return."
>
> (Senate Committee on Interstate Commerce, 74th Cong., 1st Sess., Hearings on S. 1725, p. 255.)

Respondent derives from the statements of Senator Wheeler that "Congress has indicated a preference as to who should receive the benefits of 'tax savings' from consolidated returns" (RB 53). But Senator Wheeler did not and could not speak for the Congress. On the contrary, as we have shown, Congress rejected any statutory condemnation of tax saving payments and authorized the S. E. C. to permit such payments, subject to the Committee's approval of their fairness.

d. The Treasury Department.

Respondent asserts that "The rulings of the Treasury Department * * * provide for a pro rata allocation of the consolidated tax without tax saving payments" (RB 46). The opposite is true, as we have shown (MB 72-73): The Treasury Department is concerned only with the collection of the taxes due the Government; it is wholly indifferent to the method of the inter-company allocation of consolidated taxes. One of the very rulings cited by respondent (RB, App. 20, 24) so holds:

> "The [Internal Revenue] Bureau is not concerned with arrangements made between affiliated companies as to the payment of the [consolidated] tax."
>
> I. T. 3637 (1944 Cum. Bull. 258).

But, says respondent (RB 46), the Internal Revenue Bureau uses a strict allocation formula in ascertaining the

amount of earnings and profits available for dividends,* and in allocating consolidated excess profits tax to provide deductions from normal tax net income.** These allocations, however, are necessary in order to determine the amount of tax due the Government. It is understandable that the Government does not want the amount of its tax receipts to depend on private agreements made among the taxpayer corporations. But once the amount of tax due is determined, the Government is wholly unconcerned with any internal arrangements by which the members of a consolidated return group allocate or shift the tax burden.

7. The Interstate Commerce Commission.

Respondent admits (RB 48) that the I. C. C. has not dealt with the problem of the allocation of consolidated taxes. The two I. C. C. decisions cited by respondent (RB 48, fn. 14) have nothing to do with the issues at bar.

Respondent also says (RB 49) that the National Association of Railroad and Utilities Commissioners "has disapproved the treatment of a 'tax saving' as an expense". What the Association actually ruled was this: Utility companies sometimes include among their expenses not only the taxes actually paid by them, but also additional amounts of taxes which would have been payable had certain statutory deductions not been available. The Association, quite properly, condemned the companies' practice of entering on their books an expense which they actually had not incurred (RB, App. 17-20). The Association's ruling on a bookkeeping practice thus had nothing whatever to do with the problem here presented, namely, whether and under what circumstances a tax saving payment by one affiliate to another may be fair and proper.

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* I. T. 3637 (1944 Cum. Bull. 258); I. T. 3692 (1944 Cum. Bull. 261); I. T. 4085 (1951-2 Cum. Bull. 68).

** T. D. 5086 (1941-2 Cum. Bull. 46-47).

These then are respondent's "precedents". None of them holds that the subsidiary, to the exclusion of the parent, is entitled to tax savings flowing from the parent's loss and consolidated returns. None of them stands for the proposition that taxes must be allowed to rest where they fall, even if, measured by the purposes of the tax laws and fairness, they fall in the wrong pocket. Indeed, fairly read, all of these precedents permit tax savings to be treated like any other business incident. They should be apportioned, allocated and paid in accordance with the same flexible principles of fairness and equity which would govern any other kind of business transaction.

POINT III

Plaintiff was under no obligation to surrender its tax credit to respondent, without receiving a fair share of the tax savings therefrom.

Respondent predicates plaintiff's alleged duty to give its tax credit to respondent essentially upon two grounds: (1) Plaintiff, as respondent's parent, owed it a fiduciary duty of good management, and good management, it is said, required plaintiff to surrender its own tax credit to respondent; and (2) since respondent, as the debtor in reorganization was duty-bound to preserve its assets for its creditors, plaintiff, as its stockholder, owed it the statutory duty (§ 7(b) of the Bankruptcy Act, 11 U. S. C. § 25(b)) of preserving the bankrupt estate, and such preservation again obligated plaintiff to surrender its tax credit to respondent (RB 32-33, 65).*

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* § 7(b) of the Bankruptcy Act provides:

"Where the bankrupt is a corporation, * * * its stockholders * * * shall perform the duties imposed on the bankrupt by this Act."

This provision is part of § 7 which is entitled "Duties of Bankrupts" and lists such duties of the bankrupt as the attendance at creditors' meetings, compliance with the orders of the court, the giving of information to the trustee, the filing of financial statements and inventories, etc.

The first of these grounds—plaintiff's alleged fiduciary duty to respondent—has been answered in our main brief (65-69); and since respondent does not reply to what is there said, it need not be repeated here.

Respondent's second ground is as untenable as its first.

To begin with, plaintiff was no longer a stockholder of respondent at the time the consolidated returns were filed. Plaintiff had surrendered its stock in respondent to respondent's Reorganization Committee on May 1, 1944 (R. 260, 493), with the approval of the bankruptcy court (Def. Ex. 23, R. 1192, 1930). The consolidated returns were filed thereafter, on July 15, 1944 and June 15, 1945 (MB 7). Plaintiff, having thus been divested of its stock in respondent by order and authority of the bankruptcy court, was necessarily also relieved of any duties incumbent on it by reason of its stock ownership. Therefore, at the time plaintiff filed the consolidated returns, § 7(b) of the Bankruptcy Act was no longer applicable to it; hence respondent's bankruptcy imposed no duty on plaintiff to preserve respondent's assets. Moreover, since the 1944 returns and the 1942 refund claim were filed in 1945, after respondent's emergence from bankruptcy in December 1944, any argument based on previous bankruptcy relations is irrelevant.

But, assuming that plaintiff was under an obligation to preserve respondent's assets for its creditors, can it possibly be held that this required plaintiff to confer on respondent tax savings which by the very purpose of the tax laws creating them were designed for plaintiff, not for respondent? Certainly plaintiff was under no duty to deny to itself what it was entitled to, and to confer upon respondent an undeserved and unmotivated tax advantage. Nor was it duty-bound to make a gift of its tax credit to respondent any more so than of any other of its property. If plaintiff had been the owner, say, of a patent complementary to one owned by respondent, no one would argue that respondent's bankruptcy imposed an obligation on plaintiff to give respondent the free use of plaintiff's patent. Any demand by plaintiff to share in the profits result-

tions" of the trustees;* and that term includes expenses of administration, *In re Pressed Steel Car Co. of New Jersey,* 100 F. 2d 147, 150 (C. C. A. 3, 1938), cert. den. 306 U. S. 648.

We submit, therefore, that plaintiff's claim for the 1943 tax savings was clearly covered by respondent's assumption agreement of December 14, 1944, and hence was not barred by the revesting order.

C. Plaintiff was, by express statute, relieved from any requirement to present its claim to the bankruptcy court.

Respondent contends that plaintiff's claim is an "expense of administration"; as such, it could be approved only by the bankruptcy court; since that court is now closed and no other court has jurisdiction, the claim is barred (RB 90, 95-96).

Respondent's contention that the bankruptcy court had exclusive jurisdiction to pass on plaintiff's claim is contrary, however, to § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old),** which provides:

> "Every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court in which such manager or receiver was appointed so far as the same may be necessary to the ends of justice."

This statute applies to the reorganization trustees of a railroad appointed under § 77 of the Bankruptcy Act;

* Reorganization Plan, subdivision Q; *Western Pacific R. Co. Reorganization,* 233 I. C. C. 409, 452-3.

** The statute was enacted by § 3 of the Act of March 3, 1887 (24 Stat. 554), amended in 1888 (25 Stat. 436) and 1911 (36 Stat. 1104). Since September 1, 1948, the section has been replaced by § 959 of the (new) Judicial Code, 28 U. S. C. § 959 (new).

Thompson v. *Texas Mexican R. Co.*, 328 U. S. 134, 138 (1946); *Jacobowitz* v. *Thomson*, 141 F. 2d 72, 75 (C. C. A. 2, 1944); *Ziegler* v. *Pitney*, 139 F. 2d 595, 596 (C. C. A. 2, 1943).

We shall demonstrate that the statute would have authorized plaintiff to sue respondent's reorganization trustees without resort to the bankruptcy court, even though the claim was an "expense of administration"; and that respondent, having assumed the obligations of the trustees, is equally amenable to suit.

1. *The statute would have authorized plaintiff to sue the reorganization trustees without resort to the bankruptcy court.*

> "This act [i.e., Judicial Code, § 66] abrogated the rule that a receiver could not be sued without leave of the court appointing him, and gave the citizen the unconditional right to bring his action in the local courts * * *. He ceased to be compelled to litigate * * * in any other forum * * * than he would be entitled to if the property or business were not being administered by the Federal court."
>
> *Gableman* v. *Peoria, D. & E. R. Co.*, 179 U. S. 335, 338 (1900).
>
> "Necessarily, such suit may be brought in any court of competent jurisdiction and proceed to judgment accordingly."
>
> *Texas & P. R. Co.* v. *Johnson*, 151 U. S. 81, 101 (1894).

The qualifying clause of the statute—that the suit shall be subject to the general equity jurisdiction of the appointing court—does not restrict the plaintiff's right to sue the trustees or receiver outside the bankruptcy court; for "the right to sue without resorting to the appointing court * * * cannot be assumed to have been rendered prac-

tically valueless by this further provision in the same section of the statute which granted it"; *Johnson* case, *supra,* 151 U. S., at 103. The qualifying clause of the statute relates only to "the mode of enforcing such claim when judicially determined and liquidated"; *American Brake Shoe & F. Co.* v. *Pere Marquette R. Co.,* 263 Fed. 237, 240 (D. C., E. D. Mich., 1920), citing authorities; *Kennison* v. *Philadelphia & R. C. & I. Co.,* 38 F. Supp. 980, 983 (D. C., Minn., 1940); see *Willcox* v. *Jones,* 177 Fed. 870, 874-5 (C. C. A. 4, 1910).

Nearly all claims which fall under § 66 constitute "expenses of administration"; certainly "tort claims arising by virtue of the business operations of the debtor" come within that classification, 6 *Collier on Bankruptcy* (14th Ed., 1947), § 10.06, pp. 3462-3. Nevertheless their assertion outside the bankruptcy court is a matter of indisputable statutory right, established by the authorities cited and many others.

In the present case the trustees operated respondent's railroad properties pursuant to an order of the bankruptcy court (Def. Exs. 20, 22, R. 1908, 1923). Their liability arose from a transaction of theirs in carrying on this business, since their or their agents' acts * in causing plaintiff to file consolidated returns and in joining therein were incidents of that business. It follows that plaintiff could have sued the trustees "in any court of competent jurisdiction", without leave from, or resort to, the bankruptcy court.

2. *Respondent, having assumed the obligation of the trustees, is equally amenable to suit.* A plaintiff who is authorized, by statute, to sue a court-appointed trustee

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* The statutory language, permitting suit against the receiver "in respect of any act or transaction *of his*", includes the acts and transactions of his agents; *McNulta* v. *Lochridge,* 141 U. S. 327, 331 (1891).

in a forum other than the bankruptcy court appointing him, must *a fortiori* have the same freedom when suing a private corporation which has assumed the obligations of the trustee. It is unthinkable that a bankruptcy court, which is unable to shield its own officers from suits in another forum under § 66, should have power to prevent like suits against the debtor which has emerged from reorganization and assumed the liabilities of the trustees. It is equally unthinkable that the bankruptcy court's jurisdiction, which was non-exclusive during the reorganization, should become exclusive when the reorganization ends.

The courts unanimously agree with our position:

Chicago G. W. R. Co. v. *Hulbert,* 205 Fed. 248, 250-1 (C. C. A. 8, 1913);

American Brake Shoe & F. Co. v. *Pere Marquette R. Co.,* 263 Fed. 237, 240 (D. C., E. D. Mich., 1920);

Gray v. *Grand Trunk W. R. Co.,* 156 Fed. 736 (C. C. A. 7, 1907);

Hanlon v. *Smith,* 175 Fed. 192 (C. C., N. D. Iowa, 1909);

Lassiter v. *Norfolk S. R. Co.,* 163 N. C. 19, 21-22, 79 S. E. 264 (1913);

Denver & R. G. R. Co. v. *Gunning,* 33 Colo. 280, 292-3, 80 Pac. 727 (1905);

Hawkins v. *St. Louis & S. F. R. Co.,* 202 S. W. 1060, 1063-4 (Mo. App., 1918, not otherwise reported);

Bremer v. *Chicago & E. I. R. Co.,* 247 Ill. App. 406, 413 (1927, not otherwise reported);

Vandalia R. Co. v. *Keys,* 46 Ind. App. 353, 366-7, 97 N. E. 173 (1910);

Kansas City, M. & O. R. Co. v. *Latham,* 182 S. W. 717, 720 (Tex. Civ. App., 1915, not otherwise reported).

In each of these cases the receiver or trustee of a railroad had, in the conduct of the railroad's business, incurred liability to the plaintiff; upon consummation of the receivership (mostly by foreclosure sale), the reorganized railroad assumed the liabilities of the receiver; the plaintiff sued the reorganized railroad without leave from the bankruptcy court and without having his claim approved by the bankruptcy court. In each case the action was sustained.

> "* * * the terms of the statute just quoted [i.e., Judicial Code, § 66] are now as fairly applicable to said petitioner [i.e., the reorganized railroad] as they would have been to the receivers whom they have succeeded, if the latter had not been discharged and they, instead of petitioner, had been sued in respect of the alleged negligence of their servants in the suit which is the subject of this controversy. This suit was properly brought in the State court, and the latter has full jurisdiction to determine all of the issues involved therein without interference by this court [i.e., the bankruptcy court]. Texas & Pacific Railway Co. v. Johnson, 151 U. S. 81; [citing numerous additional authorities]."
>
> *American Brake Shoe* case, *supra,* 263 Fed., at 240.
>
> "Inasmuch as an action can be brought in the State court against the receivers in the Federal court, without obtaining permission of that court (U. S. Compiled Statutes, 721(3), Act 3 March 1887, ch. 373, sec. 3), *a fortiori* an action can be brought in the State court against the purchaser, after confirmation of the sale and delivery of the property to such purchaser, without permission of the Federal court."
>
> *Lassiter* case, *supra,* 163 N. C., at 21-22.

These cases are on all fours with that at bar. Plaintiff may therefore maintain this action against respondent without previous approval of its claim by the bankruptcy court.*

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* Respondent contends (RB 105-6) that any judgment herein would have to be presented to the bankruptcy court for proof and

D. Respondent's authorities do not sustain its contention that the recognition of plaintiff's claim would be contrary to the purposes of reorganization proceedings.

Respondent prefaces its arguments with certain generalizations of doubtful accuracy. It asserts that "the reorganization court must consider and act upon all possible claims which might be asserted against the reorganized company" (RB 90). This is true of provable claims; it is not true of trustees' liabilities under § 66 of the (old) Judicial Code. Neither of respondent's authorities—*Gardner* v. *New Jersey,* 329 U. S. 565 (1947), and *Foust* v. *Munson Steamship Lines,* 299 U. S. 77 (1936)—dealt with a claim such as that at bar arising from the transactions of the debtor's reorganization trustees.

Respondent also proclaims that "the reorganization must put an end to all claims" (RB 90). This is simply not so where, as here, outstanding claims are provided for by what respondent itself (RB 96) describes as the "conventional" device of an assumption agreement.

Respondent cites (RB 90, fn. 46) a long line of cases allegedly supporting its contention that the reorganization must put an end to all claims against the debtor. But respondent's authorities hold nothing of the kind. None of them involved an assumption agreement such as was here made by respondent. Indeed, in *Duryee* v. *Erie R. Co.,* 175 F. 2d 58 (C. A. 6, 1949), and in several others,* the liabilities asserted were not those of a receiver or trustee, but had arisen prior to reorganization (175 F. 2d

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allowance, which cannot be done because the bankruptcy court is closed. But respondent's authority, *Thompson* v. *Texas Mexican R. Co., supra,* 328 U. S., at 141, involved a going reorganization in which the bankruptcy court had custody of the debtor's assets. The present respondent has emerged from the tutelage of the bankruptcy court so that submission to that court is not "necessary to the ends of justice" (§ 66, *supra*).

* *Beckley* v. *Erie R. Co.,* 175 F. 2d 64 (C. A. 6, 1949); *Black* v. *Richfield Oil Corp.,* 146 F. 2d 801 (C. C. A. 9, 1944); *In re Colorado & S. R. Co.,* 84 F. Supp. 134 (D. C. Colo., 1949).

at 59) and were therefore provable claims, not within the purview of § 66. And in *McColgan* v. *Maier Brewing Co.*, 134 F. 2d 385 (C. C. A. 9, 1943), a claim for the payment of state franchise taxes, accrued against a corporation's receiver but not presented to the bankruptcy court, was rejected because, upon the discharge of the receiver, "the property [was] *unconditionally* turned back to the corporation" (134 F. 2d, at 387; italics added). In the reorganization of the present respondent, its property was not returned to it "unconditionally"; it was returned subject to respondent's agreement to assume the obligations of its trustees. No analogy leads, therefore, from respondent's authorities to the case at bar.

It is therefore submitted that the defense of bankruptcy bar is without merit and should be rejected.

POINT VI

The defenses of limitations, laches and estoppel are without merit.

1. *The Statute of Limitations* is said to bar plaintiff's claim to the 1943 tax savings, because the 1943 returns were filed on July 15, 1944, more than two years before the commencement of this action on October 10, 1946 (Calif. Code Civ. Proc., § 339(1)). However, the cause of action, if it accrued on July 15, 1944, was directed against the trustees. Respondent's liability for that claim rests on its assumption agreement of December 14, 1944 (Pl. Ex. 15, R. 499, 1711). On that date—less than two years before the commencement of this action—a new statutory period began to run with respect to plaintiff's cause of action against respondent. *Bogart* v. *George K. Porter Co.*, 193 Cal. 197, 202, 223 Pac. 959 (1924); *Anderson* v. *Calaveras Central Mining Corp.*, 13 Cal. App. 2d 338, 345, 57 Pac. 2d 560 (1936); *Daniels* v. *Johnson*, 129 Cal. 415, 61 Pac. 1107 (1900). Since the assumption agreement was a written contract within the purview of Calif. Code Civ. Proc., § 337(1), the statutory period for plaintiff's claim,

ing from the use of its patent would hardly be called the exaction of "tribute" or an attempt to capitalize on "nuisance values". No better ground exists for respondent's contention that plaintiff was obligated, because of respondent's bankruptcy, to give its tax credit to respondent without sharing in the resulting benefits.

We can see no merit in respondent's effort to demonstrate that only plaintiff, not respondent, was under a fiduciary duty to deal fairly. If it be assumed that plaintiff was under such a duty, respondent certainly owed plaintiff at least the same obligation. The result would still be the duty to deal fairly; and that is all we contend for.

POINT IV

The amount of plaintiff's recovery should be determined in accordance with the requirements of fairness.

We have urged that the standard by which to measure the transactions complained of herein is that of fairness. We believe that respondent's treatment of plaintiff—its denial to plaintiff of any and its retention of all benefit from the tax transaction—was clearly unfair. Nevertheless respondent urges, in effect, that even if this result be unfair, the courts are powerless to balance the scales. In the absence of traditional standards, such as market value, fairness, says respondent, is too vague a standard—so vague that respondent can keep its unfair gain (RB 26). But the power of the court to redress unfairness is not thus to be straitjacketed. It has been applied to so amorphous a problem as the fair division of income and expenses between two jointly operated railroads feeding traffic to each other, where both companies were managed by one of them; *Ewen* v. *Peoria & E. R. Co.*, 78 F. Supp. 312 (S. D. N. Y., 1948), cert. den. 336 U. S. 919. In the case

at bar, the determination of the requirements of fairness is, as we shall presently show, much less complex.

Respondent seeks to obscure the problem by suggesting that the Court is called upon to "make a retrospective bargain" between plaintiff and respondent (RB 82). But the courtroom is not the market place. Once a transaction between fiduciary and cestui is recognized as unfair, the consequences follow as a matter of law. The superior negotiating skill of one party, the economic weakness of the other, may fashion the terms of a deal between parties transacting at arm's length. But these factors are of no account in the judicial award of what is fair; objective standards control.

It is our primary contention that, in fairness, plaintiff is entitled to the full amount of the tax savings produced by the consolidated returns. That follows from the purpose of the tax laws to confer a tax benefit on plaintiff, not on respondent. The amount of those savings, $17,201,739 (R. 267), is amply supported by the evidence (Pl. Ex. 80, R. 924, 1825-6). Both the District Court and the Court of Appeals have found that these tax savings were produced by respondent's use of plaintiff's stock loss (R. 262, 2217-8), in spite of respondent's vigorous arguments to the contrary. Although respondent now renews its attacks upon the amount of the tax savings (RB 109), this Court will not upset the concurrent findings of fact of the two Courts below, *Comstock* v. *Group of Institutional Investors*, 335 U. S. 211, 213-4 (1948).

We submit that the inquiry as to fairness can and should stop at this point. But if instead some significance is attached to respondent's having contributed to the achievement of the savings, then, as we have shown in our main brief, at least equal significance must be given to plaintiff's contributions. Therefore, the resulting tax savings were at least the product of the joint contributions of both plaintiff and respondent engaged in a tax savings venture; and fairness would dictate that the usual joint venture yardstick of equality should apply.

POINT V

The alleged "bar of reorganization" affords respondent no defense.

Respondent asserts (RB 89 et seq.) that plaintiff's claim, however meritorious, is barred by certain orders and proceedings in respondent's reorganization. Under this heading, respondent actually advances four separate arguments:

1. The consolidated returns were filed while respondent was in the hands of its reorganization trustees; the liability could therefore be only that of the trustees; but the trustees did not have the necessary authority from the bankruptcy court to incur such liability (RB 91-93).

2. Even if the trustees incurred a valid liability to plaintiff, that liability was not assumed by respondent because respondent reacquired its assets free and clear of all rights of any person (RB 93-95, 96-99).

3. Even if plaintiff had a valid claim, it was an expense of the reorganization; the bankruptcy court had exclusive jurisdiction to pass on that claim; plaintiff did not present it to the bankruptcy court; and that court is now closed (RB 95-96, 105-6).

4. The purpose of reorganization is to put an end to all claims so that the reorganized company shall not be hampered by holdover obligations. The recognition now of a liability herein would be contrary to that purpose (RB 90).

We shall discuss these arguments in turn.

A. The authorization of the trustees by the bankruptcy court was not a prerequisite of plaintiff's claim; moreover such authorization was given.

Respondent argues (RB 91-93) that a reorganization trustee cannot validly incur any liability without approval of the bankruptcy court. Here the bankruptcy court authorized the trustees to incur "all necessary expenses of operating the railroads and conducting the business of the debtor", but directed that "any extraordinary expense" was to be subject to the prior approval of the court (Def. Ex. 20, R. 1182, 1910; Def. Ex. 22, R. 1187, 1929). The liability to plaintiff, it is said, was an "extraordinary expense" and did not have prior court approval; hence it is unenforceable.

The argument is untenable for several reasons:

1. The consolidated returns for 1944 and the refund claim for 1942 were both filed in 1945 (MB 7), long after respondent had emerged from reorganization on December 29, 1944 (R. 499). The trustees had, therefore, nothing to do with these transactions, so that the rule requiring court approval of their liabilities could not come into play.

2. The rule was also inapplicable to the returns for 1943. The doctrine that reorganization trustees cannot incur liabilities without court approval is limited to *express contract obligations;* see *Chicago Deposit Vault Co.* v. *McNulta,* 153 U. S. 554, 562 (1894).* A trustee who in the conduct of the debtor's business violates the anti-trust laws, or engages in unfair competition, or appropriates the property of another, cannot escape liability by saying that his incurring any of these liabilities was an "extraordinary ex-

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* This Court, quoting from *Lehigh Coal & Nav. Co.* v. *Central R. Co.,* 35 N. J. Eq. 426, held:

> "'* * * he [the receiver] has no authority to bind the trust *by contract* without the authority of the court. Until his contracts are approved and ratified by the court the court is at liberty to deal with them as to it shall appear just, and may either modify them or disregard them entirely * * *.'
>
> "This states the correct rule upon the subject * * *."
>
> (153 U. S., at 562; italics added.)

pense" not authorized by the court. Each of the authorities cited by respondent (RB 92, 93) involved express contract obligations arising, e.g., from a lease,* from a loan of money,** from the purchase of goods;*** or from a retainer agreement.† The present claim is based on a breach of fiduciary duty and is therefore non-contractual.

3. The present claim is not an "extraordinary expense". The filing of tax returns is an ordinary and necessary incident of running a railroad. Respondent itself proclaims that "the tax transactions were conducted in the ordinary course of business" (RB 20). The mere fact that the expense is large does not render it "extraordinary."

4. If court approval were deemed necessary, it is found in the bankruptcy court's order of March 3, 1944 (Def. Ex. 12, R. 1087, 1895). By this order the court, having been notified of the trustees' intention to file consolidated returns for 1943 and to use plaintiff's stock loss (R. 1271-2; Def. Ex. 34, R. 1272, 2025), authorized the creation of a tax reserve in connection with these returns. While the bankruptcy court did not pass on the propriety of the proposed tax transactions, it certainly cannot be argued that what the trustees did was beyond the scope of their authority. It follows that they and the estate administered by them became liable for the consequences of their conduct; *Vass* v. *Conron Bros. Co.*, 59 F. 2d 969, 970 (C. C. A. 2, 1932).

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* *Chicago Deposit Vault Co.* v. *McNulta*, 153 U. S. 554 (1894).

** *Union Trust Co.* v. *Illinois Midland R. Co.*, 117 U. S. 434, 476-7 (1886); *Northern Finance Corp.* v. *Byrnes*, 5 F. 2d 11 (C. C. A. 8, 1925); *Byrnes* v. *Missouri National Bank*, 7 F. 2d 978 (C. C. A. 8, 1925).

*** *In re Erie Lumber Co.*, 150 Fed. 817 (D. C., S. D. Ga., 1906).

† *Leiman* v. *Guttman*, 336 U. S. 1 (1949).

5. But even if it were assumed, *arguendo*, that the trustees exceeded their authority, they would still have incurred personal liability; *In re Kalb & Berger Mfg. Co.*, 165 Fed. 895, 896 (C. C. A. 2, 1908). Such liability was covered by respondent's assumption agreement, to be presently discussed, since, as respondent admits, that agreement was couched in broad language "in order to give the trustees full protection against personal liabilities" (RB 97). We submit that an obligation of the trustees for the 1943 tax savings is indisputable.

B. Respondent expressly assumed the trustees' liability for plaintiff's claim.

Respondent's argument runs (RB 93-95, 96-99): Plaintiff's claim arose while respondent was in the hands of its reorganization trustees. By its revesting order of November 27, 1944 (Pl. Ex. 14, R. 36, 499, 1711), the bankruptcy court directed the trustees to transfer the properties to respondent free and clear of the claims of any person (R. 51-52); this transfer was carried out on December 29, 1944 (R. 499). Although respondent assumed some of the obligations of the trustees, the claim here asserted was not among those assumed.

We note preliminarily that this argument, like the preceeding one, does not apply to the 1944 tax returns and the 1942 refund claim which were filed in 1945, long after the revestment. But the argument is equally unsound as it bears upon plaintiff's claim arising from the 1943 returns; for by a clear and unequivocal contract, approved by the bankruptcy court, respondent assumed the liability for that claim.

1. Respondent (RB 94-95) invokes the following provision of the revesting order:

> "* * * all of the business, assets and property constituting the debtor's estate, of every kind and character, real, personal and mixed, and all of the right,

title and interest therein of T. M. Schumacher and Sidney M. Ehrman, as Trustees herein, shall vest in and be and become the absolute property of The Western Pacific Railroad Company on said date [December 29, 1944], free and clear of all rights, claims, liens and interests of said Trustees, the former stockholders and creditors of the debtor, and of all other persons, firms and corporations whatsoever, *except as is otherwise provided in this order;* and the said Railroad Company shall thereupon be forever released and discharged from all of its debts, obligations and liabilities, *except as herein provided;* * * *."

(R. 51-52; italics added.)

The transfer of the assets to respondent free and clear of the rights of other persons was thus subject to the proviso: "except as is otherwise provided in this order". And the order did "otherwise provide" by directing respondent to execute an assumption agreement which, as we now proceed to show, encompassed the claim here alleged.

2. Paragraph 8(a) of the revesting order (R. 45-46) prescribed and approved specifically the terms of the assumption agreement to be executed by respondent (R. 76-81). Pursuant to this direction, respondent did execute the assumption agreement on December 14, 1944 (Pl. Ex. 15, R. 76, 499, 1711).

So far as here pertinent, the assumption agreement provides that

"the undersigned [i.e., respondent] does hereby:

* * * * * * *

"2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees and, without limitation thereto, any and all liabilities or obligations of the debtor in possession or said Trustees with respect to claims for personal injury or death, for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or

operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944."

(R. 78, 1712-1713.)

The assumption agreement thus included "any and all liabilities and obligations with respect to claims of any character * * * arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business". The language could not have been broader. It requires no elaboration that plaintiff's claim arose from the trustees' "conduct of the debtor's business", since the filing of tax returns was a necessary incident of the conduct of the debtor's business.

(It should be added that respondent also assumed all federal tax liabilities of the trustees, R. 1716.)

3. Respondent contends, nevertheless, that the assumption agreement did not embrace the present claim (RB 96-99). But its arguments cannot prevail against the clear language of the agreement.

(a) In the first place, respondent says that the agreement applied only to "recognized debts" (RB 97). But the agreement contains no such qualification; on the contrary, it covers claims "heretofore or hereafter asserted". If, for instance, a negligence claim arose against the trustees on the day before the agreement was signed, it did not constitute a recognized debt; still it was clearly assumed by respondent.

(b) Respondent says next (RB 97) that the bankruptcy court had exclusive jurisdiction to approve the claim, and that the assumption agreement did not eliminate the necessity of the bankruptcy court's approval. But this argument has nothing to do with the breadth of the assumption agreement. It does not negate respondent's assumption of liability for the claim here involved. Instead, it contends

that respondent's liability should have been asserted in the bankruptcy forum rather than in an ordinary court of equity. The problem thus raised is one of jurisdiction and will be dealt with later (C, *infra*).

(c) Respondent further says (RB 97-98) that the assumption agreement did not embrace *all* obligations of the trustees because the revesting order described the agreement as covering "certain obligations" of the trustees (R. 46), only those "valid and outstanding" (R. 50). But the obligation here asserted was a valid one; and the word "certain" was justified because respondent did not assume all obligations of the trustees, but only those arising from their conduct of the debtor's business and only those incurred up to December 31, 1944.

(d) Respondent next says that there existed no obligation on the part of the trustees because they could incur no liability without approval of the court (RB 98). That argument has been answered (A, *supra*).

(e) Respondent finally refers (RB 98) to the provision of the Bankruptcy Act, § 77(e)(3), 11 U. S. C., § 205(e)(3), that every plan of reorganization must provide for the payment of all costs of administration.* But the present claim is not a "cost of administration". It is at most an "expense of administration" in the same sense in which tort claims arising from the operation of the debtor's business are expenses of administration,** and hence does not fall within § 77(e)(3). However, the point is academic, since respondent's reorganization plan did expressly provide for respondent's assumption of all "current liabilities and obliga-

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* The Bankruptcy Act, § 77(e), provides, so far as here pertinent:

> " * * * the judge shall approve the plan if satisfied that: * * * (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge * * *"

** 6 *Collier on Bankruptcy* (14th Ed., 1947), § 10.06, pp. 3462-3.

based on that agreement, was four years, and had clearly not expired when this action was commenced.

2. *The defense of laches* (RB 108) is far-fetched indeed. Plaintiff was in the hands of officers and counsel who received their pay from respondent; the charge that they unduly delayed the suit comes with poor grace from this respondent. But there was no undue delay; on the contrary, our stockholders' suit in New York and the present action were commenced in July and October 1946, one year after the filing of the 1944 returns and at a time when there was not even an assurance that there would be any tax savings whatever. (The tax settlement with the Government was on August 13, 1947.)

Nor was respondent prejudiced by the alleged delay. The reorganization closed on March 28, 1946 (Def. Ex. 32, R. 1219, 2013). Respondent admits that plaintiff had time until that date to present its claim (RB 95); and by that time, its new securities had been outstanding since January 1945. There is no evidence, and respondent does not even contend, that in the additional three months until the commencement of the stockholders' action, or in the further four months until the institution of this suit, it changed its position to its detriment. On the contrary, it maintained the $10,100,000 tax reserves on its books, thus notifying the world of the insecurity of its position.

3. *The defense of estoppel* (RB 108) is predicated upon the alleged prior consolidated return practice of the Western Pacific group. But this is just giving a new name to the same argument which has been amply rebutted in this and in our main brief.

Dated, New York, N. Y., December 12, 1952.

Respectfully submitted,

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